

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

IN RE:	(
PHP HEALTHCARE CORPORATION,	(Bankruptcy No. 98-2608JKF
Reorganized Debtor	(Chapter 11
	(
PHP LIQUIDATING LLC,	(
Plaintiff	(Adversary No. 00-665
v.	(
PRICEWATERHOUSECOOPERS LLP,	(
Defendant	(

Appearances: Neal J. Levitsky, Esquire, Counsel to Plaintiff,
PHP Liquidating LLC

Christopher J. Lhulier, Esquire, Counsel to
Defendant, PricewaterhouseCoopers, LLP

MEMORANDUM OPINION¹

Before the court is the Motion for Summary Judgment² filed by Defendant, PricewaterhouseCoopers LLP (PwC), asking this court to enter judgment in its favor, as a matter of law, in this Adversary, filed by Plaintiff, PHP Liquidating LLC, (PHP Liquidating), to avoid and recover allegedly preferential transfers. PHP Liquidating was granted the authority to pursue avoidance actions on October 12, 1999, when the Debtor's Plan of Liquidation was confirmed. This Adversary was filed on June 21, 2000. During the bankruptcy, PwC was appointed to represent the Debtors as accountants and financial advisors.

¹The court's jurisdiction was not at issue. This Memorandum Opinion constitutes our findings of fact and conclusions of law.

²Adv. Docket No. 19.

PHP Liquidating alleges that PwC received \$900,000+ in the preference period on an antecedent debt, which fact was not disclosed to the court in PwC's affidavit of disinterestedness. PwC alleges that PHP Liquidating is foreclosed from raising this issue. We are requested to enter judgment in PwC's favor in this Adversary based upon orders entered on December 29, 1998,³ and December 30, 1999.⁴ PwC contends that the orders cannot be modified, because of the doctrine of *res judicata*. The orders appointed PwC as accountants and financial advisors to the Debtor and approved PwC's final fee applications, respectively. PwC contends that in entering the orders, the court implicitly recognized that PwC could not have received a preference because, otherwise, PwC would not be disinterested. If it was not disinterested, the court could not have authorized it to represent the Debtors. Based on PwC's circuitous analysis, the court must expound on the concept of disinterestedness as reflected from the record in this case. Memoranda of Law have been filed by both parties and oral argument was held on June 21, 2001. No cross-motion for summary judgment has been filed.

³Bankr. Docket No. 150. See also Adv. Docket No. 21, Exhibit C to Declaration of Christopher Lhulier in Support of PricewaterhouseCoopers LLP's Motion for Summary Judgment (Declaration of Lhulier).

⁴Bankr. Docket No. 1195. See also Adv. Docket No. 21, Exhibit E to Declaration of Lhulier.

PwC contends that PHP Liquidating's failure to object to or appeal from either order makes both final and, therefore, subject to the doctrine of *res judicata*. PHP Liquidating counters that *res judicata* does not apply to this Adversary regardless of the finality of orders because PwC failed to disclose to the court that it had received a preference from PHP Healthcare Corporation. PHP Liquidating argues that this nondisclosure prevented the court from determining whether PwC was a "disinterested professional" as required by § 327 of the Bankruptcy Code. PHP Liquidating further contends that *res judicata* applies only when the claims asserted are similar, even if not actually litigated, which, it further argues, is not the case here.

Watson v. Eastman Kodak, 235 F.3d 851, 854 (3rd Cir. 2000), reminds us that a motion for summary judgment can be granted only when "there is no genuine issue as to any material fact and ... the moving party is entitled to judgment as a matter of law." PwC admits that Watson also makes clear that it bears the burden of proof to show that there is no genuine issue of material fact.

Although the application to retain PwC as Debtor's accountant and financial advisor contained information about amounts paid by Debtor to PwC during the year before the Chapter 11 petition was

filed,⁵ the application does not disclose that within the 90 days prior to filing PwC was paid more than \$900,000. PHP Liquidating argues that at trial it will prove that the payments within the 90 days prepetition meet the elements of a preference, particularly focusing on the manner and timing of the prepetition payments.

Standards for granting summary judgment have been announced by the Court of Appeals for the Third Circuit in numerous cases, among them, Clausen Co. v. Dynatron/Bondo Corp., 889 F.2d 459 (3rd Cir. 1989), which dealt with the interplay between *res judicata* and summary judgment. Clausen found that "[s]ince in granting summary judgment ..., the bankruptcy court relied upon the *res judicata* effect of an interlocutory rather than a final judgment, that court erred, and on appeal the district court should have reversed the summary judgment." Id. at 466. The instant procedure deals with orders of this court which, PwC argues, are

⁵PHP Liquidating's Memorandum in Opposition to Defendant, PwC's Motion for Summary Judgment, pages 2 and 3, Adv. Docket No. 26, and Memorandum in Support of Defendant PwC's Motion for Summary Judgment, page 3, Adv. Docket No. 20. The application disclosed, *inter alia*, that, as of the petition date, Debtor incurred fees and costs of approximately \$725,000 for PwC's services in connection with potential restructuring and the subsequent chapter 11 filing; that PwC had received \$1,880,000 from Debtor in the year prior to the petition date (including an initial retainer of \$100,000); and that PwC waived the remaining unpaid fees and expenses owed to it of approximately \$660,000 as of the petition date.

final. In essence, PwC views this Adversary as a collateral attack on the orders.

There are three factors determinative of a *res judicata* question: a final judgment on the merits; an identity of parties or their privities; and a subsequent action based on the same cause of action as in the first case. Corestates Bank, N.A. v. Huls Am. Inc., 176 F.3d 187, 194 (3rd Cir. 1999). As to the two orders in question, clearly the first element (i.e., final judgment on the merits) is met. Whether or not the second requirement is met,⁶ we hold that the third is not. PwC correctly notes from Corestates, 176 F.3d at 202, that courts scrutinize the totality of circumstances when deciding *res judicata* claims in a bankruptcy case to determine whether "there is an 'essential similarity of the underlying events giving rise to the various legal claims.'" (Citation omitted.) PwC argues that there is essential similarity between the application for appointment of it as financial advisor/accountant to Debtor and its fee application on the one hand and the preference action on the other. We disagree. Although PwC could not be compensated if it were not first appointed, see F/S Airlease II, Inc. v. Simon, 844 F.2d 99

⁶The Debtor-in-Possession hired PwC as its accountant. The Plaintiff in this Adversary is a different entity which has some attributes of a successor with privity, but, arguably, not all. We need not address this issue at this time.

(3rd Cir.), *cert. denied* 488 U.S. 852, 109 S.Ct. 137 (1988), the relationship between appointment and payment of fees begs the question inherent in this Adversary action. PwC argues that the order authorizing PwC to render professional services to Debtor, under § 327, should be interpreted to imply that it was "disinterested." If it was implicitly disinterested, PwC argues, it could not be the holder of a preference. PwC recognizes the teaching of In re First Jersey Securities, Inc., 180 F.3d 504, 511-14 (3d Cir. 1999), in which counsel was disqualified from serving as a professional because it had received a preferential payment. The difference there and here is that in First Jersey, the issue of the preference arose in the appointment of counsel phase of the case, but here, the issue was not raised until this Adversary was filed.

The fact that PwC raises an argument of "implicit disinterestedness," in light of its involvement in U.S. Trustee v. Price Waterhouse, 19 F.3d 138 (3rd Cir. 1994), is surprising. In that case, the Court of Appeals disapproved PwC's predecessor, Price Waterhouse, from serving as the Debtor's accountant because it held a prepetition claim. Thus, PwC is well aware that to serve as a professional in a chapter 11, it must be disinterested in fact. To be disinterested, it cannot hold a prepetition claim. If PwC accepted a preferential payment to avoid the need to waive

a prepetition claim and failed to disclose same, it will be no better off than if it had held the claim unsatisfied. Conversely, even if this court could distinguish Third Circuit law and find that PwC was disinterested on the date the bankruptcy was filed because, as of that date, it did not hold a prepetition claim, its liability to the estate, if elements of a preference are proven, is an entirely different matter that is not dependent upon a determination of disinterestedness.

Regardless of the ultimate outcome on the preference, the professional must substantiate its disinterestedness. The court did not "infer" disinterestedness. It found disinterestedness based on information disclosed by PwC, which has proven to be incomplete. The court was not informed of the payments that PwC received which are now alleged to be preferential.

In re First Jersey Securities Inc., 180 F.3d 504 (3rd Cir. 1999), held that counsel was not "disinterested," within the meaning of § 101(14)(A) and (E) and § 327(a), because an actual conflict of interest arose when counsel received a preferential payment. Counsel was disqualified from serving in the case. In First Jersey Securities, on the date it filed bankruptcy the debtor transferred restricted stock to its counsel so that the stock could be sold with proceeds applied, in part, to prepetition, unpaid fees and costs. Debtor and counsel disclosed

the transfer but neither disclosed that it had been made in the preference period. The U.S. Trustee and the Securities Exchange Commission, a creditor, objected to counsel's application to be retained on the basis that the stock transfer was a preference. The bankruptcy court approved the employment. On appeal, the court held that the payment was a voidable preference because it was a payment made on an antecedent debt. Counsel's claim arose when the services were performed, not when the invoice was sent to the client. Moreover, the timing of the payment was suspect, the amount deviated from the pattern previously established by the parties, and the form (stock rather than cash) was unusual. As such, the payment was not in the ordinary course or according to ordinary business terms.

The facts of First Jersey Securities are not on all fours with those at bench. However, the Court of Appeals clearly articulated its view that a professional cannot escape scrutiny by accepting a preference. Because the Court of Appeals had no difficulty finding that the elements of the preference were established, it did not see the need to examine the adequacy of the disclosure in the application to be retained as a professional under Fed.R.Bankr.P. 2014(a). The court decided that the holder of an avoidable preference had an actual conflict and was not disinterested. In the instant case, the bankruptcy court was

deprived of the opportunity to consider the effect of the alleged preference because the parties did not specifically disclose the transactions that would have prompted the inquiry.

PwC also argues that PHP Liquidating's preference action is essentially similar to both the Debtor's application to approve PwC's appointment as financial advisor/accountant and PwC's final fee application and concludes that *res judicata* applies to bar further litigation. Again, we disagree. PwC's argument does not fully appreciate the rationale of First Jersey Securities. Although the application to retain PwC for professional services contains substantial and significant information about PwC's prepetition relationship with Debtor, it does not disclose material information; that is, that a \$900,000 payment from Debtor to PwC occurred within the preference period.

PwC quotes a proposition from one of our recent decisions, In re York, 250 B.R. 842, 845 (Bankr. D. Del., 2000), that "a final order that is not appealed cannot be collaterally attacked in a later proceeding even if the order was entered in error." This language of In re York speaks to a Chapter 13 plan confirmation order, not to an order which appointed a professional. However, the merits of the orders appointing PwC and authorizing its fees are not at issue in this proceeding. What is at issue is the *res judicata* effect of those orders on an entirely different cause of

action. We note, since PwC directs our attention there, that the relevant statutory reference concerning applications of professional is to sections of the Bankruptcy Code dealing with their retention and compensation. Section 327(a) provides:

Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

Section §330(a)(1) provides:

After notice to the parties in interest and the United States trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103 -

(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person....

These provisions have been interpreted such that courts may deny compensation to professionals with conflicts, who are not appointed prior to rendering services, and who are not disinterested.⁷

⁷See F/S Airlease II, Inc. v. Simon, 844 F.2d 99 (3rd Cir. 1988), and In re Marvel Entertainment Group, Inc., 140 F.3d 463 (3rd Cir. 1998).

In In re BH & P Inc., 949 F.2d 1300 (3rd Cir. 1991), the bankruptcy court's ruling on the issue of disinterestedness of a trustee and counsel who breached a duty of disclosure was upheld. The bankruptcy court determined that both were not disinterested, that both should be disqualified, and that both had knowingly and intentionally breached a duty of disclosure. The district court upheld the findings regarding disinterestedness and disqualification. The Court of Appeals for the Third Circuit, after determining that the existence of interdebtor claims would not in every instance require disqualification, held that the bankruptcy court was correct on all three findings. The appellate court interpreted § 327(a) and analyzed the detriment to the estate created by disqualification of counsel. It stated:

... the issues centering upon the bankruptcy court's disqualification and removal of Maggio and RGZ could well affect assets in the three on-going Chapter 7 proceedings. The disqualification and removal were imposed, in part, in order to ensure that conflicts of interest would not affect the viability of BH & P's contested claims against Herman and Berkow. Furthermore, the court's ruling has the more remote but no less real effect of increasing the estates' administrative costs by requiring that separate trustees and professionals be retained in each case.

Id. at 1307. The court balanced the interests of judicial economy with disinterestedness of professionals hired by debtor and found

the latter more important. Further in the decision the court reasoned:

As the district court noted, section 101(14)(E), the so-called "catch-all clause" governing lack of disinterest, has been held "broad enough to include anyone who 'in the slightest degree might have some interest or relationship that would even faintly color the independence and impartial attitude required by the Code and Bankruptcy Rules.'"

Id. at 1309 (citations omitted).⁸ If we were to apply the Court of Appeals' interpretation of § 101(14)(E), we would be pressed to inquire whether there is a material fact in dispute as to whether PwC was a "disinterested person" within the meaning of § 327(a), and whether the court's approval of PwC was improvident in light of information first presented in this Adversary. However, in this Adversary, we are not called upon to take that route. All we

⁸We take note of the analysis in In re Park-Helena Corp., 63 F.3d 877 (9th Cir. 1995), *cert. denied sub nom. Neben & Starrett, Inc. v. Chartwell Financial Corp.*, 516 U.S. 1049, 116 S.Ct. 712 (1996):

The firm did not initially explain that the payment was actually made by ... president, Meyer, out of Meyer's personal checking account. It only disclosed these details after Chartwell objected to [the] fee request.... [It is argued] that the distinction between Meyer and "the Debtor" is one of form over substance because Meyer's personal check reflected funds that he owed to Park-Helena. Thus [it is argued] the retainer was paid with funds "of the debtor," and the statement in the Application for Employment, that [payees] received a retainer "paid by the debtor," was accurate and sufficient.

We reject this argument.... "Coy, or incomplete disclosures ... are not sufficient.'"

63 F.3d at 880-81 (citations omitted). Although Park-Helena dealt with the application for fees by an attorney, the underlying principle of candor toward the bankruptcy court by a professional requesting appointment for and professional fees from a Debtor applies.

need do is determine whether PwC's appointment as a professional and approval of fees in the case prohibits an action to recover an undisclosed and allegedly preferential payment. We find that neither order prohibits the Adversary on the facts of this case. Because the issues in the Order of appointment and the order approving fees do not involve the elements of a preference under § 547 or § 550, *res judicata* is inapplicable.

There are material facts in dispute as to whether the payments PwC received in the preference period are avoidable. Thus, this action will proceed to trial. For the foregoing reasons, we find that PwC has not sustained its burden to show that judgment can be entered in its favor, as a matter of law, and its motion for summary judgment is, therefore, denied. Neither the court's order authorizing PwC to serve as Debtor's accountant and financial advisor nor its order approving fees considers the alleged preferential payments. Neither PwC nor Debtor disclosed an alleged preference to the court at any appropriate time regarding appointment or payment of fees. Both were under a continuing duty to disclose that payments were made within the preference period. It is no longer possible to litigate, in a motion to retain or in an application for final fees, the question of whether PwC received a preference, but this Adversary seeking to prove the preference will go forward.

An appropriate order will be entered.

DATE: 5/7/02

_____/s/
Judith K. Fitzgerald
United States Bankruptcy Judge

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FOR DISTRICT OF DELAWARE

IN RE:

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Reorganized Debtor	(Chapter 11
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	(
PHP LIQUIDATING LLC,	(
Plaintiff	(
	(Adversary No. 00-665
v.	(
	(
PRICEWATERHOUSECOOPERS LLP,	(
Defendant	(

ORDER DENYING MOTION FOR SUMMARY JUDGMENT
AND SETTING DATE FOR STATUS CONFERENCE

AND NOW, this **7th** day of **May, 2002**, for the reasons expressed in the foregoing Memorandum Opinion, it is **ORDERED, ADJUDGED, and DECREED** that the Motion for Summary Judgment of **PRICEWATERHOUSECOOPERS, LLP** is **DENIED**.

It is **FURTHER ORDERED** that the a status conference to discuss pretrial matters and schedule trial shall be held on **June 18, 2002, at 12:30 p.m.**, Courtroom #1, in Delaware.

_____/s/_____
Judith K. Fitzgerald
United States Bankruptcy Judge

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